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MEMORANDUM FOR THE RECORD

SUBJECT: Production Cutbacks to Maintain Crude
Oil Prices

The attached information on surplus crude oil production and the cutbacks taken to maintain prices was prepared in response to a question from Alan Greenspan, Chairman of the President's Council of Economic Advisors.



Office of Economic Research

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Production Cutbacks to Maintain Crude Oil Prices

The surplus of crude oil production over consumption, which was on the order of 3 million b/d in July, has been sharply reduced by production cutbacks in some OPEC countries and in Canada. In September the surplus was reduced to about 1 million b/d because of production cutbacks, ^{this month} and, because of rising seasonal consumption, we believe production and consumption are ~~now~~ roughly in equilibrium. About 65% of the cutbacks were borne by three producers -- Kuwait, 570,000 b/d; Libya, 550,000 b/d; and Abu Dhabi, 300,000 b/d. Virtually all the cutbacks are the result of company refusals to lift at current high prices. The producer governments, faced with the choice of limiting production or cutting prices, have usually chosen the former.

Increased consumption during the winter will eliminate the surplus with consumption exceeding production. However, if consumers choose to draw down stocks rather than increase imports, a small surplus might continue to exist. On the other hand, a severe winter or a prolonged coal strike could increase the need for imports. All in all, it is unlikely that any OPEC country will be required to make extensive additional cuts this winter for the purpose of maintaining prices.

Should additional cuts be necessary either this winter or next year, they probably will be made. Kuwait and Abu Dhabi, which can easily afford a reduction in revenues, would undoubtedly limit production rather than accept a substantial price cut. Production in Venezuela, Libya, and Canada, is expected to continue to decline because of a variety of causes, not all of which are related to price maintenance. Under present circumstances, Saudi Arabia, Iran, Indonesia, and Nigeria are unlikely to limit output. However, if faced with a marked deterioration of their per barrel earnings, even these countries would probably be willing to take some cuts. The attitude of Iraq remains, as usual, unpredictable.

In summary, it is not probable that surpluses this winter will be large enough to exert strong downward pressure on prices, but, in the event that additional cutbacks are necessary to maintain prices, a number of countries would be willing to make the required cuts.